

December 6, 2002



Supply Inventory Management

Accountability and Control of
Materiel at the Naval Air Depot,
North Island
(D-2003-033)

Department of Defense
Office of the Inspector General

Quality

Integrity

Accountability

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Acronyms

NIF	Naval Industrial Fund
MRP II System	Manufacturing Resource Planning II System



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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December 6, 2002


MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Report on Accountability and Control of Materiel at the Naval Air Depot,
North Island (Report No. D-2003-033)

We are providing this report for your information and use. This report is one in a series being issued by the Inspector General of the Department of Defense that discusses accountability and control of materiel at maintenance depots. We considered management comments on a draft of this report when preparing the final report.

Comments on a draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Dennis E. Payne at (703) 604-8907 (DSN 664-8907) or Mr. Joseph M. Austin at (703) 604-9178 (DSN 664-9178). See Appendix B for the report distribution. The audit team members are listed inside the back cover.


David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General of the Department of Defense

Report No. D-2003-033

(Project No. D2000LH-0285.003)

December 6, 2002

Accountability and Control of Materiel at the Naval Air Depot, North Island

Executive Summary

Who Should Read This Report and Why? DoD personnel who are involved in materiel management of aviation spare parts should read this report. The report discusses compliance with policies and procedures used to account for and control materiel at Naval Air Depot, North Island.

Background. This is the fourth in a series of reports the Inspector General of the Department of Defense is issuing that discusses accountability and control of materiel at DoD maintenance depots. The DoD FY 2002 budget for depot maintenance was approximately \$15.3 billion. The Navy portion of that amount was about \$6.8 billion. Close to \$1.5 billion of the \$6.8 billion was for operation of three Naval Air Depots. A significant portion of the \$1.5 billion was for purchasing materiel used in repair and overhaul processes at the depot maintenance facilities. Inventory records at Naval Air Depot, North Island showed that \$55 million of materiel was stored in 19 maintenance storerooms. The audit covered 12 of the 19 maintenance storerooms.

Depot maintenance facilities need effective inventory control systems to ensure that an adequate supply of materiel is on hand to maintain efficient levels of operation and to meet the demands of customers. An effective system is also important to disclose defective and obsolete goods; prevent loss through damage, pilferage, or waste; and ensure the accuracy inventory records. Through inventory control, materiel not needed for current requirements at a depot can be identified and made available for redistribution to meet other known requirements.

Results. Materiel stored in maintenance storerooms at Naval Air Depot, North Island in San Diego, California exceeded requirements. Also, significant levels of materiel stored in work center storerooms were not recorded on accountable records. As a result, the Naval Air Depot, North Island had as much as \$40 million of excess, unrecorded materiel on hand that was not visible to item managers to satisfy known requirements. Also, our stratified sample of 539 inventory records at Naval Air Depot, North Island produced an estimated count error rate of about 8.8 percent. Large and inaccurate inventories made materiel difficult to manage. Unrecorded materiel lacks visibility, making it vulnerable to loss, obsolescence, and theft. Increased management controls over maintenance materiel will improve the accuracy of the Naval Air Depot, North Island inventory, reduce excess materiel, and correct material management control weaknesses identified in this report. (See the Finding section for the detailed recommendations.)

Management Comments. The Navy concurred with the finding and recommendations and provided additional comments on specific sections of the report. The Navy comments were responsive; therefore, no additional comments are required. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

This report is the fourth in a series of reports resulting from our audit of accountability and control of materiel at DoD maintenance depots. The DoD FY 2002 budget for depot maintenance was approximately \$15.3 billion. The Navy portion of that amount was about \$6.8 billion. Close to \$1.5 billion of the \$6.8 billion was for operation of three Naval Air Depots. A significant portion of the \$1.5 billion was for purchasing materiel used in the repair and overhaul processes at the depots.

Naval Air Depot, North Island. Naval Air Depot, North Island (North Island) located in San Diego, California, is one of the three Naval Air Depots. The North Island mission includes airframe programs, engine programs, component repair, in-service engineering and logistics support, and other support. Systems that North Island supports include the E-2, C-2, F/A-18, and S-3 aircraft and the LM2500 engine.

Materiel Classification. Materiel used at maintenance depots is generally classified as consumable or repairable. Consumables are supplies consumed while in use, such as repair parts and fabrication materiel. Once in use, consumables lose a separate identity. Repairables are secondary items, or subassemblies, that can be restored to a serviceable condition through depot-level maintenance and normally exchanged on a one-for-one basis. For each repairable issued to maintenance for repair or overhaul, a serviceable repairable should be returned to the supply system.

Accounting For and Controlling Materiel. Inventory control is defined as the control of materiel and goods in process by accounting and physical controls. Accounting control involves proper recording and reporting of inventories. Physical control involves the physical movement of inventories and consists of proper safeguards for receiving, storing, handling, and issuing materiel. The purpose of a physical inventory is to validate an item's storage location and determine the condition and quantity of items by physically inspecting and counting items.

Inventory control is important because materiel not needed for current requirements at a depot can be identified and made available for redistribution to meet other known requirements. Each depot maintenance facility is required to record on-hand inventory balances on shop stock records. Shop stocks are demand-supported repair parts or consumable items that are stored within the depot maintenance facility to support workloads. For accounting purposes, shop stocks are considered consumed; however, depot maintenance facilities are required to maintain shop stock records to show on-hand inventory balances. Depot maintenance facilities need effective inventory control systems to ensure that an adequate supply of materiel is on hand to maintain efficient levels of operation and to meet the demands of customers. An effective system is also important to disclose defective and obsolete goods; prevent loss through damage, pilferage, or waste; and ensure the accuracy of inventory records.

Management Oversight. The Naval Air Systems Command is the office of primary responsibility for the three Naval Air Depots within the Navy and provides overall guidance for managing materiel at the depots. Naval Air Systems Command Instruction 4400.5A, “Materiel Inventory Control Policy and Procedures for Naval Air Depots,” July 2, 2002 (NAVAIRINST 4400.5A), provides policy and procedural guidance for management and control of materiel at the Naval Air Depots.

Storage of Materiel. Materiel used in the fabrication, manufacture, and overhaul processes at North Island is stored in either nine Focus stores or 10 Naval Industrial Fund (NIF) stores (storerooms). Focus stores are located within depot work centers and are managed by Fleet and Industrial Supply Center personnel. NIF stores are also located within depot work centers and are managed by contractor personnel.

Manufacturing Resource Planning II System. At North Island, maintenance materiel is managed on the Manufacturing Resource Planning II system (MRP II System). The MRP II System is a computerized database, which maintains on-hand inventory balances and locations of the inventory. The MRP II System is the official accountability record for maintenance materiel stored at the maintenance facility.

Objectives

The overall objective was to evaluate the effectiveness of policies and procedures used to account for and control materiel at Naval Air Depot, North Island. We also reviewed the management control program as it related to the overall objective. See Appendix A for a discussion of the scope and methodology, our review of the management control program, and prior coverage.

Management of Materiel at the Naval Air Depot, North Island

Materiel stored in maintenance storerooms at North Island exceeded requirements. Also, significant levels of materiel stored in work center storerooms were not recorded on accountable records. Excess, unrecorded materiel accumulated in maintenance storerooms because North Island did not comply with the Navy guidance regarding management of materiel and did not perform quarterly reviews of materiel to determine whether materiel was required. Excess materiel also accumulated because maintenance facility personnel were reluctant to turn in unused materiel when jobs were completed. Additionally, the lack of an adequate management control program and the lack of Naval Air Systems Command oversight contributed to the problem of accumulating excess materiel. As a result, North Island had about \$40 million of materiel in excess to known requirements stored at the depot. Also, inventory records at North Island had count error rate of about 8.8 percent. Large and inaccurate inventories made materiel difficult to manage. Additionally, excess, unrecorded materiel was not available to item managers to satisfy valid requirements and, lacking visibility, was vulnerable to loss, obsolescence, and theft.

Guidance on Managing Maintenance Materiel

DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," May 20, 1998, provides policies for DoD Components regarding management of materiel. The regulation states that the DoD Component that has physical custody of materiel is responsible for the care and safeguarding of the materiel and shall maintain quantitative balance records by individual storage location. The DoD Components shall also conduct annual physical inventories and shall take appropriate actions to ensure that the on-hand quantity and total item property records agree.

Chief of Naval Operations Instruction 4790.2H, "The Naval Aviation Maintenance Program," April 11, 2001, designates the Naval Air Systems Command as the office of primary responsibility for the Naval Aviation Maintenance Program and provides policies and procedures for managing maintenance materiel at the depots.

NAVAIRINST 4400.5A states that "all materiel will be accounted for and costed to the benefiting job order number." The instruction also states that unrecorded materiel shall not be accumulated in any area of the Naval Air Depots and materiel not used on jobs for which it was issued shall be returned to the appropriate materiel manager for proper disposition before closing the job. The Naval Air Depots are also required to conduct quarterly reviews of materiel stored in their depot maintenance facilities to ensure that excess, unrecorded materiel does not accumulate. The instruction requires that records of such actions be maintained for a period of 2 years.

Inventory Valuation

The value of materiel stored in Focus and NIF stores at North Island was unknown. May 13, 2002, inventory records at North Island showed that materiel valued at about \$48 million was stored in nine Focus storerooms. Inventory records as of May 21, 2002, showed that materiel valued at about \$7 million was stored in 10 NIF storerooms. However, the actual value of materiel stored in the Focus and NIF storerooms was understated because some materiel was not recorded on accountable records and other materiel recorded on accountable records lacked associated cost data. As a result, we were unable to determine the overall dollar value of materiel maintained in Focus and NIF storerooms at North Island.

Focus Stores. Inventory records showed that about \$48 million of maintenance materiel was stored in nine Focus storerooms. However, each of the nine Focus storerooms also had residual materiel from completed jobs that was not recorded on accountable inventory records. For example, one of the nine Focus storerooms maintained a non-accountable inventory record of residual materiel. The inventory, valued at about \$7 million, was understated because many items on the inventory record did not have associated cost data. The remaining eight Focus storerooms did not maintain any type of inventory records for residual materiel.

NIF Stores. The inventory records showed that about \$7 million of maintenance materiel was stored in 10 NIF storerooms. However, inventory records for each of the NIF storerooms had many items that did not have associated cost data. For example, 645 inventory records for one NIF storeroom did not have associated count data for any of the materiel. As a result, we could not determine the total value of materiel stored in NIF maintenance storerooms.

Storage of Maintenance Materiel

Materiel stored in maintenance storerooms at North Island exceeded requirements. Also, large amounts of materiel stored in the work center storerooms were not recorded on accountable records and were excess to any known requirements. Specifically, materiel valued at about \$40 million was excess to any known requirements and was not recorded on accountable records.

Materiel Requirements. Materiel stored in maintenance storerooms within three Focus storerooms exceeded requirements. We judgmentally selected locations within three of nine Focus storerooms and performed physical inventories. We then determined whether materiel was excess. Each of the three Focus storerooms had excess materiel, even though NAVAIRINST 4400.45A states that materiel not used on jobs for which the materiel was issued is to be returned to the appropriate depot maintenance personnel for proper disposition. The three Focus storerooms had about \$40 million of materiel on hand that was residual materiel from completed jobs. Timely disposition of residual materiel is necessary to prevent the accumulation of excess materiel.

Unrecorded Materiel. Large amounts of materiel stored in work center storerooms were not recorded on accountable records. We judgmentally selected for physical inventory 442 line items of residual materiel within 3 work areas outside of Focus storerooms. Our physical inventory showed that about \$21 million of materiel was not recorded in the MRP II System and, therefore, was not visible to any potential customers. For example, inventory for 61 line items of materiel, valued at about \$8.3 million, was left over from completed jobs. NAVAIRINST 4400.45A states that all materiel will be accounted for and unrecorded inventories shall not be accumulated in any area of a Naval Air Depot. Unrecorded materiel results when materiel issued to a job is not used on that job and is not properly disposed of at job closeout. NAVAIRINST 4400.5A also states that all materiel issued to a job in excess of requirements of that job will be returned to the appropriate inventory manager for proper disposition.

In addition to the unrecorded materiel valued at about \$21 million that we identified by our physical inventory, we identified about \$12 million of additional materiel from a 400-page inventory listing within the F/A-18 aircraft shop and \$7 million from an inventory listing within the hydraulic shop that was not recorded on accountable records. Many line items of materiel included in the inventory listing did not have unit prices or extended dollar values. The unrecorded materiel should be considered excess because it was not identified with any ongoing project or as satisfying any known requirement. North Island personnel did not comply with Navy guidance regarding the storage of materiel and did not determine whether a requirement for the leftover materiel existed. We believe that the about \$40 million of unrecorded and excess materiel within the three maintenance storerooms is a small amount of the unrecorded materiel because records regarding excess materiel were maintained in only three of the nine maintenance storerooms.

Excess Materiel

Excess materiel accumulated at North Island because personnel did not comply with Navy guidance regarding management of materiel and did not perform quarterly reviews of materiel to determine whether the materiel was required. Excess materiel also accumulated because maintenance personnel were reluctant to turn in unused materiel when jobs were completed. Additionally, the lack of an adequate management control program and the lack of Naval Air Systems Command oversight contributed to the problem of accumulating excess materiel.

Purchasing Materiel. North Island purchased required materiel at the beginning of jobs and stored that materiel for the life of the job without determining whether materiel was already on hand. North Island personnel could not provide records showing that jobs were reviewed at closeout to determine whether leftover materiel could be used on other jobs as NAVAIRINST 4400.5A requires. Also, North Island personnel could not provide records showing that new requisitions were placed only after determining that required materiel was not on hand from previously completed projects. Further, records showing how North Island maintenance personnel accounted for materiel that was reclaimed from repaired

components or removed from assets in maintenance were not available. Purchasing materiel more in line with consumption would reduce the excess inventories, especially because program requirements can change.

Quarterly Reviews. North Island personnel did not perform quarterly reviews on materiel stored in Focus and NIF storerooms as NAVAIRINST 4400.5A requires. The instruction requires that materiel be reviewed quarterly, at a minimum, to determine whether requirements exist. Quarterly reviews would have identified that excess materiel was accumulating. North Island personnel were aware of the requirement to perform the quarterly reviews and prepare reports regarding the reviews; however, North Island personnel did not perform the quarterly reviews because the Naval Air Systems Command did not request the reports.

Turn-in of Materiel. Maintenance personnel at North Island stated they were reluctant to turn in excess materiel because they believed the excess materiel could be used for future needs. Maintenance personnel also stated that they were saving customers' money by not turning in materiel and wanted to avoid the fees charged to dispose of the materiel because credit was not given for some of the materiel turned in.

Accuracy of Inventory Records. The inventory records for accountability and control of materiel stored in Focus and NIF storerooms at North Island were inaccurate. For our physical inventory of the Focus and NIF stores, we statistically selected 539 records (479 Focus storeroom records and 60 NIF storeroom records) from a universe of 28,582 records (26,673 Focus storeroom records and 1,909 NIF storeroom records) to determine whether quantities that were on hand matched the quantities identified in Focus and NIF storeroom inventory records. We compared the balance shown on the Focus and NIF storeroom inventory records with the physical count of items stored in the Focus and NIF storerooms.

The comparison of inventory records with the physical inventories showed count errors. By applying statistical weighting to the sample, we calculated that the number of errors in the universe of 28,582 records to be about 2,521 (8.8 percent).

Because of the high error count rate between the inventory records and the physical inventories, we believe that a physical inventory of materiel should be performed and inventory records adjusted accordingly.

Management Oversight of Materiel

The lack of Naval Air Systems Command management oversight of maintenance materiel also contributed to the problem of accumulation of excess materiel at North Island. Additionally, the lack of a management control program contributed to the problem.

DoD and Navy Regulations. DoD and Navy regulations collectively require that maintenance depots maintain quantitative balance records, account for materiel on

formal records from the time of acquisition until the materiel is consumed or disposed of, conduct annual physical inventories, and take actions that ensure the on-hand quantity and inventory records agree. Those requirements were issued to ensure the care and safeguarding of materiel.

Naval Air Systems Command Policy. NAVAIRINST 4400.5A requires that Naval Air Depots review materiel on hand on a quarterly basis to determine whether a valid requirement exists for the materiel. The instruction also requires a systematic review of materiel on at least a quarterly basis to ensure excess, unrecorded materiel does not accumulate. Records of such actions are required to be maintained for 2 years.

North Island personnel stated that required reviews were not performed and that reports were not prepared because Naval Air Systems Command did not require North Island to submit reports. Naval Air Systems Command should require quarterly reports so that it can monitor inventory levels and to ensure that Naval Air Depots are in compliance with NAVAIRINST 4400.5A.

Management Control Program. The lack of a management control program also contributed to the excess, unrecorded materiel on hand at North Island. DoD regulations require that DoD organizations implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Navy guidance requires that all components maintain effective accounting and administrative controls. Also, each management level is required to continually evaluate, document, and test its controls using the specified management control review process. The Chief of Command Evaluation, North Island, stated that a management control program had not been in existence at North Island for the last 3 years. Although addressed in the Navy report, "Command Inspection of Naval Aviation Depot North Island San Diego, California," July 17, 2000, the lack of a management control program had not been corrected. The Navy report stated that the command evaluation office, which is responsible for reviewing management controls, did not have an effective management control program, and was not reporting to proper authorities. Additionally, the report stated that the command evaluation office had not developed a command evaluation plan and did not perform reviews and evaluations of programs. However, as of May 2002, North Island did not have a management control program in place.

Monetary Benefits

The audit identified excess, unrecorded materiel valued at about \$40 million. Therefore, North Island could have \$40 million of potential monetary benefits. The exact amount cannot be determined until North Island identifies inventory excess to prevailing requirements and determines whether the excess materiel can be used to satisfy other known requirements.

Conclusion

North Island did not comply with Navy guidance relating to the stockage of maintenance materiel and did not effectively manage the materiel. As a result, North Island had at least \$40 million of materiel on hand that was not recorded on accountable records and was excess to any known requirements. Also, inventory records had a count error rate of about 8.8 percent. Because materiel stored in maintenance storerooms is considered consumed, the materiel loses visibility and is not available to supply system item managers to meet other requirements. Storage of large quantities of unrecorded materiel makes maintenance inventories difficult to manage. Because unrecorded materiel lacks visibility, it is vulnerable to loss, obsolescence, and theft.

Management Comments on the Finding

Navy Comments. The Navy concurred with the finding and provided additional comments to specific paragraphs in the finding. The Navy stated that the Naval Air Depot, North Island has led the effort to restructure the way supply support is provided to the Naval Air Depots by entering into a partnership with the local Fleet and Industrial Supply Center. This is relevant in that partial responsibility for materiel management is moving to the Fleet and Industrial Supply Center. This supply transformation effort is geared at dramatically improving all aspects of supply support and related functions at all three Naval Air Depots. The Navy also stated that audits such as this one serve to highlight problems and validate the wisdom of the ongoing difficult transformation. The Navy further stated that it was confident that any deficiencies noted during the audit would be resolved as quickly as possible.

Recommendations and Management Comments

1. We recommend that the Commander, Naval Air Systems Command ensure that the Naval Air Depot, North Island:

a. Comply with Navy guidance regarding the storage of maintenance materiel at the depot, performance of quarterly reviews of maintenance materiel on hand, and submission of management reports for review.

Navy Comments. The Navy concurred, stating that the recommended actions would be completed by June 30, 2003.

b. Develop and implement an effective management control program.

Navy Comments. The Navy concurred, stating that the recommended actions would be completed by April 30, 2003.

2. We recommend that the Commander, Naval Air Depot, North Island immediately:

a. Inventory materiel stored in work center storerooms, record all of the on-hand materiel on accountable records, identify the materiel for which a valid need exists, and return the items with no known requirement to the supply system.

Navy Comments. The Navy concurred, stating that the recommended actions would be completed by September 30, 2003.

b. Review jobs at closeout to determine whether a need exists for leftover materiel. Leftover, unneeded materiel should be made visible to item managers and disposed of in a timely manner.

Navy Comments. The Navy concurred, stating that recommended actions would be completed by April 30, 2003.

c. Perform the required quarterly reviews of materiel stored in work center storerooms to determine whether valid requirements exist for the materiel.

Navy Comments. The Navy concurred, stating the recommended actions would be completed by September 30, 2003.

d. Perform physical inventories of materiel stored in all storage locations and adjust inventory records accordingly.

Navy Comments. The Navy concurred, stating that the Naval Air Depot, North Island conducts annual physical inventories and is in the process of inventorying all work centers to ensure that materiel is recorded in the MRP II. The Navy stated that the planned actions would be completed by September 30, 2003.

Appendix A. Scope and Methodology

We performed the audit at the Naval Air Depot, North Island located in San Diego, California. We contacted personnel at the Naval Air Systems Command and the Naval Supply Systems Command. We concentrated on accountability and control of repair parts and consumable materiel. Inventory records as of May 13, 2002, showed that materiel valued at \$48 million was stored in nine Focus stores. Inventory records as of May 21, 2002, showed that materiel valued at \$7 million was stored in 10 NIF stores.

We reviewed DoD and Navy regulations regarding policies, responsibilities, and procedures for managing repair parts and consumable materiel at depot maintenance facilities. To determine whether repair parts and consumable materiel were accurately accounted for and controlled on depot inventory records, we physically inventoried materiel stored in the Focus and the NIF storerooms. We also determined whether annual inventories and quarterly reviews were performed and whether management reports were prepared. We statistically selected for review 539 records (479 Focus storeroom records and 60 NIF storeroom records) from a universe of 28,582 records (26,673 Focus storeroom records and 1,909 NIF storeroom records). The statistical sample included records for nine Focus storerooms and records for only 3 of the 10 NIF storerooms because data was not available for the other 7 NIF storerooms when the sample was drawn. For materiel stored in other areas of work centers, we judgmentally selected three work centers for review. We determined unit prices by using the Defense Logistics Information Service Federal Logistics Record dated November 1, 2000, and North Island inventory records as of May 13, 2002, and May 21, 2002. We performed this audit from March through September 2002 in accordance generally accepted government audit standards.

Use of Computer-Processed Data. We relied on computer-processed data from the Navy MRP II System for determining the accuracy of inventory records. Our review of system controls and the results of data tests showed an error rate that casts doubt on the data's validity. Further, we believe that the monetary valuation of materiel was understated because a significant amount of materiel stored in the Focus and the NIF storerooms had no extended dollar value. However, when the data are reviewed in context with other available evidence, we believe that the opinion, conclusions, and recommendations in this report are valid.

Sample Design. We used a stratified random sample design and in each stratum selected simple random samples of records reported as of May 13, 2002, for Focus storerooms and random samples of records reported as of May 21, 2002, for NIF storerooms, as shown in the following table.

Population and Sampling

<u>Store</u>	<u>Records in System</u>	<u>Records in Sample</u>
Focus 41	7,292	125
Focus 42	4,122	125
Focus 43-45	4,457	65
Focus 46	3,821	65
Focus 47-49	6,981	99
NIF 1-3	<u>1,909</u>	<u>60</u>
Total	28,582	539

Sample Results. Using the stratified sample design, we calculated statistical projections of the errors of materiel count in storage locations, and the projected values of overstated and understated value of the inventories.

Based on the sample results, and by using a 90 percent confidence level, we project that between 1,869 and 3,172 records have materiel count errors at North Island, and that the point estimate 2,521 is the mid point of the range of values. We further project that the understated value of the materiel in error is between \$770, 950 and \$2,783,729, and that the point estimate, \$1,777,339 is the mid point of the range of values. Also, the overstated value of the materiel in error is between \$71,023 and \$620,879, and that the point estimate of \$345,951 is the mid point of the range of values.

Use of Technical Assistance. Statisticians from the Analysis, Planning, and Technical Support Directorate, Quantitative Methods Division, Office of the Inspector General of the Department of Defense provided assistance in designing a random statistical sampling plan for performing physical inventories and in evaluating the results of the samples.

High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the Defense Inventory Management high-risk area.

Management Control Program Review

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of the Review of the Management Control Program. We reviewed the adequacy of management controls at North Island regarding storage and disposition of maintenance materiel at the depot. As of May 2002, North Island did not have a management control program in place.

Adequacy of Management Controls. We identified material management control weaknesses for North Island as defined by DoD Instruction 5010.40. North Island management controls for managing depot maintenance materiel were not adequate because managers stored for long periods materiel not needed for requirements. Also, quarterly reviews to determine whether materiel was needed were not performed, including reviews of materiel stored for long periods. Recommendations 1. and 2., if implemented, will improve management of materiel. A copy of the report will be provided to the senior official responsible for management controls within the Navy.

Adequacy of Management's Self-Evaluation. North Island did not have a management control program in place; therefore, management did not perform a self-evaluation.

Prior Coverage

During the last 5 years, the Inspector General of the Department of Defense (IG DoD) has issued three reports that discuss management of repair parts for maintenance. Unrestricted IG DoD reports can be accessed over the Internet at <http://www.dodig.osd.mil/audit/reports>.

IG DoD

IG DoD Report No. D-2002-091, "Accountability and Control of Materiel at the Corpus Christi Army Depot," May 21, 2002

IG DoD Report No. D-2002-003, "Accountability and Control of Materiel at the Tobyhanna Army Depot," October 4, 2001

IG DoD Report No. D-2001-186, "Accountability and Control of Materiel at the Tobyhanna Army Depot – Stockage of Communications-Electronics Materiel," September 21, 2001

Appendix B. Report Distribution

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Department of the Navy Comments



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
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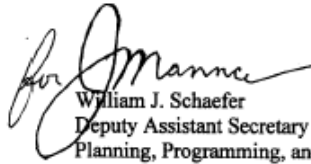
MEMORANDUM FOR THE OFFICE OF THE ASSISTANT INSPECTOR GENERAL FOR
AUDITING, READINESS AND LOGISTICS SUPPORT
DIRECTORATE

Subj: DRAFT REPORT ON ACCOUNTABILITY AND CONTROL OF MATERIEL AT
THE NAVAL AIR DEPOT, NORTH ISLAND (PROJ: D2000LH-0285.003)

Ref: (a) DoDIG Draft Report D2000LH-0285.003

Encl: (1) DoN Comments to Draft Report D2000LH-0285.003

In response to reference (a), enclosure (1) is forwarded as the Department of the Navy comments to the subject draft audit. My point of contact should you need additional information is CDR Bob Miedzinski at 703-695-0611.


William J. Schaefer
Deputy Assistant Secretary of the Navy
Planning, Programming, and Resources

Copy to:
NAVAIR (00G4A)

DEPARTMENT OF THE NAVY RESPONSE TO
DODIG DRAFT REPORT ON ACCOUNTABILITY AND CONTROL
OF MATERIEL AT THE NAVAL AIR DEPOT, NORTH ISLAND
(PROJECT NO. D2000LH-0285)

Finding: Management of Materiel at the Naval Air Depot, North Island

Materiel stored in maintenance storerooms at North Island exceeded requirements. Also, significant levels of materiel stored in work center storerooms were not recorded on accountable records. Excess, unrecorded materiel accumulated in maintenance storerooms because North Island did not comply with the Navy guidance regarding management of materiel and did not perform quarterly reviews of materiel to determine whether materiel was required. Excess materiel also accumulated because maintenance facility personnel were reluctant to turn in unused materiel when jobs were completed. Additionally, the lack of an adequate management control program and the lack of Naval Air Systems Command oversight contributed to the problem of accumulating excess materiel. As a result, North Island had about \$40 million of materiel in excess to known requirements stored at the depot. Also, inventory records at North Island had count error rate of about 8.8 percent. Large and inaccurate inventories made materiel difficult to manage. Additionally, excess, unrecorded materiel was not available to item managers to satisfy valid requirements and, lacking visibility, was vulnerable to loss, obsolescence, and theft.

DON Comments: Concur.

Recommendation No. 1: We recommend that the Commander, Naval Air Systems Command ensure that the Naval Air Depot, North Island:

a. Comply with Navy guidance regarding the storage of maintenance materiel at the depot, performance of quarterly reviews of maintenance materiel on hand, and submission of management reports for review.

DON Comments: Concur. Estimated completion date is 30 June 2003.

b. Develop and implement an effective management control program.

DON Comments: Concur. Estimated completion date is 30 April 2003.

Recommendation No. 2: We recommend that the Commander, Naval Air Depot, North Island immediately:

a. Inventory materiel stored in work center storerooms, record all of the on-hand materiel on accountable records, identify the materiel for which a valid need exists, and return the items with no known requirement to the supply system.

Enclosure (1)

DON Comments: Concur. Estimated completion date is 30 September 2003.

b. Review jobs at closeout to determine whether a need exists for leftover materiel. Leftover, unneeded materiel should be made visible to items managers and disposed of in a timely manner.

DON Comments: Concur. Estimated completion date is 30 April 2003.

c. Perform the required quarterly reviews of materiel stored in work center storerooms to determine whether valid requirements exist for the materiel.

DON Comments: Concur. Estimated completion date is 30 September 2003.

d. Perform physical inventories of materiel stored in all storage locations and adjust inventory records accordingly.

DON Comments: Concur. NADEP North Island conducts annual inventories. They are in the process of inventorying all work center stored materiel to ensure this materiel is recorded in our current management system, Materiel Resource Planning (MRP) II. This ensures the materiel is accounted for and visible to all programs. Estimated completion date is 30 September 2003.

DON General Comments: Naval Air Depot (NADEP) North Island has led the effort to restructure the way Supply support is provided to the NADEP by entering into a partnership with the local Command, Fleet and Industrial Supply Center (FISC). This is relevant in that partial responsibility for material management is moving to FISC. This supply transformation effort is geared at dramatically improving all aspect of supply support and related functions at all three NADEPs. Audits such as this one serve to highlight problems and validate the wisdom of the ongoing difficult transformations underway. We are particularly proud of NADEP North Island's efforts in this regard; we are not happy with any deficiencies, but are confident they will be resolved as quickly as possible.

Specific Comments:

Page 4, paragraph 1, "Inventory Valuation".

DON Comments: Do not concur. There appears to be confusion between Focus, Navy Industrial Fund (NIF), accumulation areas and shop excess. Although, excess/unreconciled inventory exists, some of the excess inventory is due to material located near the accumulation areas, which are assigned to a production requirement. Accumulation areas exist to stage materiel that has completed processing, removal, by-pass, or purchase.

Both FISC and NADEP North Island perform independent audits and reviews for this inventory depending on the system of record. Current initiatives are in place to address shop excess.

Page 4, paragraph 2, "Focus Stores".

DON Comments: Do not concur. A FISC inventory audit team manages maintenance storerooms/FISC Focus Store inventory accuracy. This team reports directly to the FISC San Diego Commanding Officer, in accordance with Naval Supply Systems Command (NAVSUP) Publication 723. Audit results are maintained for two years. The Focus Store inventory accuracy rate for third quarter is 97.93%. NIF inventory is also managed by FISC San Diego and undergoes a wall-to-wall inventory annually. The inventory accuracy acceptance rate is 95% or greater. NADEP North Island Command Evaluation and Control Office reviews and evaluates this inventory with the assistance of personnel from the Comptroller Department. NADEP North Island contractor-managed Hazardous Materiel recorded a 90% inventory accuracy, which placed them on notice of contract violation. Since the audit the contractor has been replaced. The NAVSUP accuracy goal is 98% accuracy. The inventory accuracy rate for the third quarter of this fiscal year was 97.93%.

Page 4, paragraph 3, Inventory Valuation, "NIF Stores".

DON Comments: Do not concur. NADEP North Island complies with NAVAIR Instruction 4400.5A. Materiel is inventoried annually on a wall-to-wall basis. The accuracy is 98% and is reviewed and evaluated by NADEP North Island Command and Evaluation Control Office along with the Comptroller Department. This portion of the audit was complicated by the transfer of stock (bearing inventory) from NIF to BP-28

Page 4, paragraph 4, Inventory Valuation, "Storage of Maintenance Materiel".

DON Comments: Partially concur. Inventory in excess of requirements in Focus Stores is due to excessive lead times in procuring materiel. This could only be reduced through better wholesale support. Work center materiel costs are overstated, as much of this materiel is located near production staging areas.

Page 4, paragraph 5, Storage of Maintenance Materiel, "Material Requirements".

DON Comments: Do not concur. Focus Store inventory is retail stock (NAVICP BP-28 funded) and is located in close proximity to our production areas. All Focus Stores and NIF Stores have a distinct physical barrier, which divides Focus Store/NIF materiel from the excess materiel identified in your findings. This applies to Buildings 379 and 94. Focus Store materiel is audited by FISC's inventory audit team as defined in NAVSUP Publication 723. The FISC San Diego audit team insures physical accountability and the inventory management team provides quarterly excess reports.

Page 5, paragraph 3, "Excess Materiel".

DON Comments: Concur. NADEP North Island has current initiatives in place to turn in and record inventory in their MRP II Netting Stores. This materiel will be recorded in their standard MRP II system and this materiel will be consumed prior to any additional materiel being requisitioned. NADEP North Island will incorporate oversight into the Management Controls Program.

Page 5, paragraph 4, Excess Materiel, "Purchasing Materiel".

DON Comments: Partially Concur. Materiel purchased for a job is not stored for the life of a job. Once received, it is linked up to the required job it was ordered against and utilized. NADEP North Island is currently developing methods to review jobs at close out to determine if leftover materiel could be used on other jobs. This materiel will be recorded and consumed prior to any additional materiel being requisitioned.

Page 6, paragraph 1, Excess Materiel, "Quarterly Reviews".

DON Comments: Partially concur. NIF inventory is posted on the standard NAVAIR Industrial Materiel Management System (NIMMS). NAVAIR can access the information on line and does not require paper copies. The majority of the inventory is maintained by FISC San Diego on the U-2 System. Quarterly excess reviews of Focus Store materiel is performed on NAVSUP, Navy Working Capital Fund (Navy Retail Stock Program, BI-28). This materiel is managed by FISC San Diego. Quarterly reviews are performed utilizing the Uniform Data Automation and Processing System application M (UM-04 and UM-05). Although there have been programming deficiencies associated with this system, and recognized by NAVSUP, FISC San Diego utilizes local unique programs to accomplish this requirement. In FY02, FISC San Diego reported \$2.6 million dollars of excess in the second quarter and \$1.8 million in the third quarter. This materiel was offered to the respective Defense Logistics Agency Inventory Control Points. As of first quarter FY03, NADEP North Island now conducts quarterly reviews of NIF inventory

Page 6, paragraph 4, "Accuracy of Inventory Records".

DON Comments: Partially concur: As NADEP North Island transitions from their legacy systems to MRP II, many of their system transactions are batch processed. They have identified interface deficiencies in transferring information to and from MRP II. An example is that although the on hand quantity was reduced on the U-2 inventory record, U-2 did not send notification to pull the materiel. This has been resolved through standard reconciliation reports on a daily basis. Inventory accuracy for the Focus Stores is managed and conducted by FISC San Diego inventory audit team, which reports directly to FISC San Diego Commanding Officer, in accordance with the Publication 723. Audit results are maintained for two years in accordance with the publication. The Focus Store inventory accuracy rate for third quarter FY02 was 97.93%. NIF inventory

is also managed by FISC San Diego and undergoes a wall-to-wall inventory annually. This is in accordance with NAVAIR Instruction 4440.12. The inventory accuracy rate is 98%.

Page 7, paragraph 1, "Management Oversight of Materiel".

DON Comments: Partially Concur. Accountable inventory in Focus Stores and NIF Stores are managed in accordance with NAVSUP Pub 723 and NAVAIRINST 4440.12. At the time of this audit, NADEP North Island had a Management Control Program (MCP) instruction in draft. Since the audit, they have commenced implementing the MCP program. NADEP North Island's inventory of assessable units will include material inventory, to include shop sweeps and turn in procedures for excess materiel. They have also submitted the FY 02 Annual Statement of Assurance/Certified Statement for the MCP to NAVAIR.

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